

## **DISCLAIMER**

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## **APPLICATION OF**

**WASHINGTON GAS LIGHT COMPANY,  
VIRGINIA DIVISION**

**CASE NO. PUE970328**

**For an annual informational filing**

## **REPORT OF DEBORAH V. ELLENBERG, CHIEF HEARING EXAMINER**

**June 25, 1998**

On March 31, 1997, Washington Gas Light Company, Virginia Division (“WGL” or the “Company”), filed its annual informational filing (“AIF”) with the Commission. The AIF contained financial and operating data for the twelve months ending December 31, 1996. On August 1, 1997, the Staff of the Commission filed a report on the AIF, finding that after applying an earnings test based on actual test year jurisdictional earnings, average rate base, average capital structure, and with limited adjustments to place the test year results on a regulatory basis, the Company earned a return on equity of 12.16%,<sup>1</sup> which was in excess of its authorized return on equity of 11% to 12%. Staff recommended that the Company write off the Virginia jurisdictional portion of unamortized losses on reacquired debt. The Company opposed that recommendation and by motion filed on August 29, 1997, requested a hearing to address Staff’s proposal. On September 8, 1997, the Commission issued an order scheduling a hearing before a hearing examiner for October 16, 1997.

The hearing was convened as scheduled. Donald Hayes, Esquire, appeared on behalf of the Company. Sherry Bridewell, Esquire, appeared on behalf of the Commission Staff. A transcript of the hearing is filed with this report. Simultaneous briefs were filed on December 12, 1997.

## **SUMMARY OF THE RECORD**

Staff proposes to apply an earnings test to determine if WGL has recovered certain regulatory assets. Specifically, Staff asserts that the Company has recovered its losses on reacquired debt. Staff witnesses Richard W. Taylor, manager of audits with the Division of Public Utility Accounting, and Donna T. Pippert, principal financial analyst in the Division of Economics

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<sup>1</sup>On cross examination Staff agreed that an additional adjustment should have been made to place WGL’s books on a ratemaking basis for the earnings test. Staff recognized that it should have taken into account the ten percent of excess margins allocated to shareholders through the risk sharing mechanism. That adjustment would have reduced the return on equity to 12.10%, but did not affect Staff’s recommendation. (Tr. 41-43). Staff, therefore, did not offer a revised earnings test to reflect that adjustment.

and Finance, offered testimony in support of that position.<sup>2</sup> WGL presented the testimony of Frederic M. Kline, vice president and treasurer of the Company, and Benjamin A. McKnight, a certified public accountant and partner in the firm of Arthur Andersen LLP, in support of the Company's position opposing Staff's use of an earnings test in this case.<sup>3</sup>

WGL raises capital through the issuance of securities, including long-term debt securities.<sup>4</sup> When debt is issued the Company incurs issuance expenses for activities such as underwriting, legal, printing, and obtaining a rating. These issuance expenses are amortized over the life of the new debt. Debt discounts and premiums may also be paid to adjust an interest rate to make a debt security marketable. Although not expenses per se, such costs are treated in a manner similar to other issuance expenses. Nonregulated companies treat debt issuance expenses in the same manner as utilities.

A loss on reacquired debt is an accounting classification for several different expenses associated with the retirement or reacquisition of debt securities prior to their maturity.<sup>5</sup> When debt is retired early, the accounting for any remaining unamortized issuance expenses must be changed to reflect the fact that the debt is no longer outstanding. Early retirement may also result in prepayment penalties or call premiums, which are the costs of calling in debt for early retirement at a premium price.<sup>6</sup> When a debt issue is retired early, any call premiums and the remaining issuance expenses are combined and classified as losses on reacquired debt.<sup>7</sup> Under the normal accounting procedures for a nonregulated company, a loss on reacquired debt is expensed in the year it is incurred; however, the Standards of Financial Accounting Statement ("SFAS") 71 allows a utility company to create a regulatory asset if it is probable that future revenues will be provided to recover the asset.<sup>8</sup> The Commission's normal practice has been to reflect the losses on reacquired debt as a debt expense and allow recovery in that cost of debt over the life of the new debt.<sup>9</sup>

Historically, the Company has recovered losses on reacquired debt through an adjustment to the cost of long-term debt. There are two components to the adjustment. First, there is a reduction in the debt ratio for the amount of the unamortized loss.<sup>10</sup> Second, the cost of debt is increased for the reacquisition loss.<sup>11</sup> The Company's current rates include such an adjustment. The Company's

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<sup>2</sup>Exhs. RWT-3, 4, and DTP-8.

<sup>3</sup>Exhs. FMK-1, 10, and BAM-9.

<sup>4</sup>Exh. FMK-1, at 12.

<sup>5</sup>Exh. DTP-8, at 2.

<sup>6</sup>Id. at 3.

<sup>7</sup>Id.

<sup>8</sup>Id. and Exh. RWT-4, at 9.

<sup>9</sup>Id.

<sup>10</sup>Exh. FMK-2, Schedule 3, at 2

<sup>11</sup>Id., Schedule 4, at 2.

regulatory asset related to losses on reacquired debt is recorded on the Company's books as a deferred asset and amortized over the life of the refunding debt.<sup>12</sup>

The losses on reacquired debt at issue in this case total \$8,874,305, as detailed on Staff witness Pippert's Schedule 1 and attached hereto as Appendix A.<sup>13</sup> The Virginia jurisdictional portion, \$3,275,162, was calculated by Staff witness Taylor using a net plant allocation factor.<sup>14</sup>

Staff argues that present recovery should be viewed in light of actual earnings to avoid potential double recovery caused by concurrent overearnings and continued amortization and deferral of regulatory assets.<sup>15</sup> If the entire amount of the Virginia jurisdictional share of WGL's losses on reacquired debt is considered recovered, the Staff's earnings test would yield a return on equity of 11.21%, slightly above the bottom of WGL's authorized range of 11% to 12%.<sup>16</sup>

The Company opposes the use of the earnings test. It disagrees with the formulation, and more importantly, the application of the Staff's earnings test. The Company argues that the Staff's recommendation would unconstitutionally confiscate shareholder equity without due process. The Company also asserts that application of the earnings test violates the Commission's rate case rules and would impede the Company's financial flexibility in the future. The Company further argues that use of the earnings test would constitute poor public policy, particularly since there is an alternative means through a performance-based regulatory plan to eliminate regulatory assets from the Company's books without adversely affecting the Company's financial position. Finally, the Company asserts that if the Commission determines that an earnings test is appropriate in this proceeding, a properly formulated test would not show excessive earnings during the test period.

## **DISCUSSION**

After all forward-looking adjustments, Staff found the Company's return on equity to be 12.08% which is slightly above the authorized range.<sup>17</sup> On a going-forward basis Staff concluded that the overearnings position was not significant and therefore, does not warrant a full review of WGL's rates at this time.<sup>18</sup> Therefore, the sole issue in this case centers on the Staff's formulation and application of an earnings test.

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<sup>12</sup>Exh. FMK-1, at 12.

<sup>13</sup>Exhs. RWT-3, at 3 and DTP-8, Schedule 1. An addition error in the total loss on reacquired debt in the attached schedule has been corrected. The losses from the listed debt issues which were reacquired total \$8,874,305, not \$8,871,374 which was the sum in the schedule attached to Exh. DTP-8.

<sup>14</sup>Exhs. DTP-8, at 4 and RWT-4, at 2-3.

<sup>15</sup>Exh. RWT-3, at 6.

<sup>16</sup>Id. at 4-5, Revised Exhibit 3.

<sup>17</sup>Id.

<sup>18</sup>Id. at 8.

Before addressing the application of an earnings test to judge the recovery of a regulatory asset, it is first important to understand the nature of a regulatory asset, how and why it is created. A regulatory asset is a deferral of a current period cost amortized over an extended period of time for ratemaking. Generally a prudently incurred cost may be deferred for future recognition only when a company incurs an unusually large or nonrecurring cost that causes financial results to be materially and negatively affected by currently expensing the cost. Such deferrals allow a regulated company to recover extraordinary expenses from ratepayers over extended periods. A regulatory asset is thus an effective sharing mechanism providing some degree of rate stability and protection for the ratepayer and an opportunity to recover extraordinary but reasonable costs for the company. However, as the Commission has found, “deferral of any costs is unusual and should be allowed for ratemaking purposes only rarely and in extreme situations.”<sup>19</sup>

In several previous cases, the Commission has evaluated test period recovery of a number of regulatory assets, including Postretirement Benefits other than Pensions (“OPEB”) implementation costs, electric capacity contract charges, and extraordinary storm damage costs.<sup>20</sup> More recently, the Commission is considering application of an earnings test to evaluate recovery of rate case expenses, costs of a depreciation study, franchise costs, LNG tank painting costs, union contract negotiation costs, and more.<sup>21</sup>

Here, the Staff has evaluated losses on reacquired debt. Losses on reacquired debt are somewhat different from the other regulatory assets that have been reviewed in light of an earnings test to date. Notably, a specific stream of benefits in the nature of reduced debt costs over a particular period of time results from retiring more expensive debts early. Moreover, WGL’s losses on reacquired debt have been established with extended amortization periods ranging from seven to thirty years.

Staff proposes to apply an earnings test to determine if WGL has recovered its losses on reacquired debt. An earnings test is a per books measurement of historic test period earnings based on average rate base and investment. Adjustments are made to restate the per books data to a regulatory basis, but the purpose of the test is to review actual test period earnings, not to set future rates.

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<sup>19</sup>*Application of Appalachian Power Company*, Case No. PUE940063, 1996 S.C.C. Ann. Rep. 255, 257.

<sup>20</sup>*See also Ex Parte: In the matter of establishing Commission policy regarding rate treatment of purchased power capacity charges by electric utilities and cooperatives*, Case No. PUE880052, 1988 S.C.C. Ann. Rep. 346; *Ex Parte, In re: Consideration of a rule governing Accounting for Postretirement Benefits other than Pensions*, Case No. PUE920003, 1992 S.C.C. Ann. Rep. 315; *Appalachian Power Company*, Case No. PUE940063, 1996 S.C.C. Ann. Rep. 255; *Application of Washington Gas Light Company*, Case Nos. PUE950006 and PUE960042, 1996 S.C.C. Ann. Rep. 262; *Application of Southwestern Virginia Gas Company*, Case No. PUE960028, 1996 S.C.C. Ann. Rep. 307; and *Application of Shenandoah Gas Company*, Case No. PUE960068, 1996 S.C.C. Ann. Rep. 311.

<sup>21</sup>*Application of Appalachian Power Company*, Case No. PUE940063, 1996 S.C.C. Ann. Rep. 255; *Application of Roanoke Gas Company*, Case Nos. PUE960304 and PUE960102, Hearing Examiner Report (April 30, 1998).

A per books earnings test has been used as a threshold test to determine whether costs associated with a regulatory asset have been recovered or whether they should be deferred and amortized.<sup>22</sup> The test has also been used more recently to determine whether previously approved regulatory assets have been recovered.<sup>23</sup>

*The losses on reacquired debt at issue in this case  
were not unreasonable expenses.*

The Company first argues that losses on reacquired debt are legitimate and reasonable expenses which it has been previously authorized to recover through an adjustment to its cost of debt. WGL argues that it refunds debt only when prevailing interest rates allow issuance of new debt at lower rates which result in savings sufficient to outweigh losses on reacquired debt.<sup>24</sup> The Company also argues that Staff's proposal may discourage efforts to retire debt.<sup>25</sup> Yet, Staff does not assert that the expenses were unreasonably incurred.<sup>26</sup> Rather, Staff agrees that such losses are a proper cost of obtaining savings. Staff does not object to the establishment of a regulatory asset for reasonable costs when the losses are not already recovered in the current period. Staff, however, asserts that the expenses have already been recovered, and therefore should no longer be reflected on the Company's books. The Company should be reminded that regardless of the Commission's decision on the proper formulation and application of an earnings test in this case, if the Company is found to be foregoing opportunities for cost savings, excessive interest costs may be subject to future disallowance.<sup>27</sup>

*Application of an earnings test in this case does not constitute  
retroactive ratemaking or confiscation of shareholders' earnings.*

The Company next argues that application of the earnings test to assess earnings during the test period constitutes retroactive ratemaking. I disagree. Retroactive ratemaking has been narrowly construed in Virginia to occur only when retroactive increases or decreases are ordered to depart from previously approved Commission rates.<sup>28</sup>

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<sup>22</sup>*Application of Appalachian Power Company*, Case No. PUE940063, 1996 S.C.C. Ann. Rep. 255.

<sup>23</sup>*Application of Roanoke Gas Company*, Case Nos. PUE960304 and PUE960102, Hearing Examiner Report (April 30, 1998).

<sup>24</sup>Exh. FMK-1, at 13.

<sup>25</sup>*Id.* at 15.

<sup>26</sup>Tr. 97-98.

<sup>27</sup>Exh. DTP-8, at 8.

<sup>28</sup>*Vepco v. State Corporation Commission*, 226 Va. 541, 549 (1984).

The Virginia Supreme Court has held that retroactive ratemaking is an “attempt to go back in time to order refunds of revenues collected under rates that were legally in effect at the time the revenues were collected.”<sup>29</sup> The Company compares Staff’s proposal to a 1977 Commission case in which Staff concluded that several gas utilities had earned in excess of their authorized returns due to colder than normal weather and proposed refunds based on those earnings.<sup>30</sup> There, the Commission rejected Staff’s proposal.

Certainly, the Commission’s power to fix rates is strictly prospective.<sup>31</sup> Here, however, no refunds are ordered and no change is proposed to the rates now in effect. Rather, Staff has analyzed earnings during the test period, does not propose to go outside the test period, and simply has concluded that those earnings were sufficient to have recovered certain deferred costs earlier than anticipated at the inception of the regulatory assets. Staff’s proposal does not constitute retroactive ratemaking.

The Company also argues that the Staff’s recommendation to write off regulatory assets results in confiscation of earnings from a past period, which belong to shareholders, and application of those earnings to a new use for the benefit of ratepayers.<sup>32</sup> That, the Company argues, is fundamentally the same as suggesting refunds of past earnings.

However, application of the earnings test does not constitute confiscation of shareholder earnings as argued by the Company. The treatment of regulatory assets is unique to regulated entities. A nonregulated company operating under Generally Accepted Accounting Procedures (“GAAP”) would expense the charge in the period it was incurred. Earnings in the period of the original deferral were higher than they would have been had there been no deferral. Thus, contrary to the Company’s assertion that earnings would be confiscated, the regulated utility and its shareholders benefited from the original deferral when the expense was deferred for recovery in a later period rather than being charged against earnings in the period incurred.

According to SFAS 71, deferral of a charge as a regulatory asset is appropriate if the recovery of the asset is probable in future rates. Staff maintains, and I agree, that recovery is not only probable, in the case of the recovery of losses on reacquired debt, it occurred earlier than had been anticipated. It is, therefore, simply no longer necessary to reflect the deferral on the Company’s books. The write-off of Virginia jurisdictional losses in 1998 will reduce book earnings, but not cash flow in 1998. The cost of the losses on reacquired debt remains in rates, and therefore, as noted above, there is no immediate effect on current rates or the Company’s cash flow.<sup>33</sup>

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<sup>29</sup>*Commonwealth Gas Pipeline v. Anheuser-Busch*, 233 Va. 396, 402 (1987).

<sup>30</sup>*Commonwealth of Virginia, ex rel. State Corporation Commission, Ex Parte, in re: Investigation to determine the impact of abnormal weather conditions on the earnings of privately owned electric and gas utilities*, Case No. 19820, and *Commonwealth of Virginia, ex rel. State Corporation Commission, In re: Petition of Elizabeth M. Howell*, Case No. 19811, 1977 S.C.C. Ann. Rep. 255, 258.

<sup>31</sup>*Commonwealth of Va., ex rel. Town of Appalachia v. Old Dominion Power Co., Inc.*, 184 Va. 6 (1945).

<sup>32</sup>Exh. FMK-10, at 2, 6.

<sup>33</sup>Tr. 46, 56-57.

*Staff application of the earnings test is not prohibited by the  
Commission's rules or the Company's prior case.*

The Company argues that application of an earnings test violates the Commission's rules, and further, is inconsistent with the Commission decision in WGL's last rate case. Since the Commission is bound by its own rules,<sup>34</sup> WGL reasons that the rate case rules require the Commission to consider only "[a] fully adjusted rate of return on jurisdictional operations. . . in order to allow the Commission and its staff to adequately evaluate the Company's financial condition."<sup>35</sup> WGL argues that since a fully adjusted rate of return would consider all accounting adjustments to revenues and cost of service, the Commission is somehow precluded from applying an earnings test with its limited adjustments, and notably, with no weather adjustment, in the AIF process.

The Company, however, cannot point to any provision of the rules that prohibits use of an earnings test. Moreover, the Commission clearly has held that the rules do not preclude Staff or other parties from raising issues which they believe should be addressed.<sup>36</sup> The Staff advised all utilities of its intent to propose an earnings test to evaluate regulatory assets. Further, testimony including Staff's specific recommendation in this case was prefiled well before the hearing. Certainly the Company had notice that the issue was going to be raised and thus has had ample opportunity to present its position on application of the earnings test.

An AIF is used to judge the adequacy of current rates going forward. If the review indicates a company's earnings are over or under the approved range for a reasonable return on equity, the Commission can initiate a rate case and consider prospective rate changes. However, an AIF is also used to assess a company's actual earnings during the test period. Staff's application is thus consistent with one of the purposes of the AIF, analysis of test period earnings. That analysis properly takes place in the context of an Annual Informational Filing or a rate case and does not violate the Commission's rate case rules.

The Company also argues that the Commission's rules of practice and procedure require the Commission to give reasonable notice of and conduct a hearing on the content of any general order, rule or regulation before promulgation. The issue in this case addresses WGL and its regulatory assets, and will not directly impact any other utility any more than any other accounting adjustment proposed in the course of a company-specific rate case. Application of an earnings test to judge WGL's recovery of regulatory assets does not violate the Commission's rules of practice and procedure.

The Company next asserts that in its last case, PUE940031, a dispute arose over the cost of long-term debt used in computing the Company's cost of capital. The difference in positions

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<sup>34</sup>*Virginia Committee for Fair Utility Rates v. Virginia Electric and Power Company*, 243 Va. 320 (1992).

<sup>35</sup>Rule I.(9).

<sup>36</sup>*Application of Virginia Electric and Power Company*, Case No. PUE880014, 1988 S.C.C. Ann. Rep. 312, 314.

resulted from the amortization period proposed for issuance expenses.<sup>37</sup> The hearing examiner adopted Staff's proposed 30-year period because it corresponded with the maturity date of the bonds at issue. He noted that "Staff's proposal will protect both the ratepayers and Company from any under- or overrecovery of capital costs."<sup>38</sup> The Company therefore claims that it is entitled to recover its regulatory assets. Yet, the creation of regulatory assets does not guarantee regulated companies that every dollar of an expense will be recovered, but rather, that they will have a reasonable opportunity to earn a fair and reasonable return.

Staff's proposal does not prevent the Company from earning a fair rate of return. An integral part of the earnings test is to verify that the cost of capital was covered. Customers therefore are not relieved of the cost of a debt refinancing. Rates were established at a level sufficient to allow recovery of the losses on reacquired debt. If the Commission accepts Staff's adjustment, it would not be disallowing recovery of a regulatory asset, rather, it simply would be recognizing that the asset was recovered earlier than expected.

*Only adjustments necessary to restate actual data to a regulatory basis need to be made in an earnings test.*

Staff recommends that certain adjustments should be made before the earnings test is conducted to judge the recovery of regulatory assets. The per books financial data in an earnings test should be adjusted to restate books to a regulatory basis. Job development credit ("JDC") capital expense and associated tax savings should be included. Average, not year-end investment should also be used.

Although the Company generally opposed formulation of an earnings test, it also opposed Staff's application if such a test is to be applied, and argues that the test year data should be weather-normalized. WGL points to the deferral of OPEB implementation costs which were normalized. Staff has acknowledged that a weather normalization adjustment is appropriate in an earnings test applied to OPEB, stating that "[t]his was appropriate due to the extended amortization period (forty years) afforded these deferrals".<sup>39</sup> The recovery of regulatory assets at issue in earlier cases, however, was not measured by a weather-normalized test, and had amortization periods of between three and five years. The Company's losses on reacquired debt at issue in the instant proceeding have amortization periods ranging from seven to 30 years.<sup>40</sup> Almost 96% of the total amount has an amortization period of least ten years.<sup>41</sup> The Company argues that losses on reacquired debt are thus more like OPEB costs.

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<sup>37</sup>*Application of Washington Gas Light Company*, Case No. PUE940031, Report of Glenn P. Richardson, Senior Hearing Examiner at 44 (May 26, 1995).

<sup>38</sup>*Id.* at 45.

<sup>39</sup>Exh. RWT-3, at 5.

<sup>40</sup>Exh. DTP-8, Sch. 1.

<sup>41</sup>Tr. 106, 107.



The purpose of an earnings test, however, is to judge actual earnings during the test period; therefore, with the exception of OPEB, which for gas companies was subject to a weather-normalized earnings test at its inception, actual earnings should serve as the focus. While it is important to weather normalize revenues of a historic period when setting rates for the future because it is impossible to forecast weather for a future period with any certainty, there is no need to adjust for normal weather when your purpose is to review already known earnings during the test period. In addition, such an adjustment is inappropriate for most regulatory assets because “normal” weather does not occur over the short term.<sup>42</sup> Weather normalizing known revenues and cost data will distort the Company’s actual earnings for the test period. Moreover, as a practical matter weather normalizing for some regulatory assets but not for others would further complicate the test, and potentially generate arguments over the distinction between short- and long-lived assets. I agree with Staff that the earnings test to judge the recovery of a regulatory asset should not be weather-normalized.

*Deferred costs in this case should be considered recovered only when the Company’s earnings exceed the authorized return on equity range.*

The final component of the application of an earnings test in this case focuses on what point within the authorized range of return on equity should be used to measure the recovery of regulatory assets. The Company asserts gas rates are set at the midpoint of the range and thus also argues against Staff’s proposal to recognize regulatory assets as recovered to the bottom of the return on equity range.<sup>43</sup> However, the point is only necessary when setting a new revenue requirement.<sup>44</sup> The Commission has found that:

the range, not the point, is the proper mark. The Commission’s determination of a reasonable range of return on equity is made in a general rate case after hearing expert testimony on the subject, all of which is generally expressed in the form of a range, or band, given the admittedly imprecise nature of the judgments and analyses involved. When the Commission adopts a range, its finding simply reflects that the utility has the need, and right, to an opportunity to earn a return on equity somewhere within that

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<sup>42</sup>Tr. 129; *See Application of Washington Gas Light Company*, Case Nos. PUE950006 and PUE960042, 1996 S.C.C. Ann. Rep. 262.

<sup>43</sup>Exh. FMK-1, at 11.

<sup>44</sup>*Application of Virginia Electric and Power Company*, Case No. PUE880014, 1988 S.C.C. Ann. Rep. 312, 314.

range. Future earnings anywhere within that range will be lawful, and will be considered neither excessive nor insufficient.

. . . .

the only real necessity for picking an exact point within the range is so that precise tariff rates can be calculated. Fixing such a point is thus a far less important part of the ratemaking process than determining the range itself.<sup>45</sup>

The Commission went on to note that “[t]he fact that the Company did not actually earn [its authorized return] on equity during the test year has no bearing on this issue. It is only entitled to the opportunity to earn. . . its lawfully approved range.”<sup>46</sup>

The Commission, as noted earlier, applied the earnings test to determine whether Appalachian Power Company should be allowed to defer costs associated with extraordinary storm damage.<sup>47</sup> There, the Commission allowed deferral and recovery of only that portion of the costs that would have caused earnings to fall below the bottom of the authorized range. The Commission reasoned that earnings above the bottom of the range were reasonable.<sup>48</sup>

In this case, two debt issues were reacquired during the test year. In 1996, the Company reacquired debt with a 9¼% interest rate due April 15, 2018; unamortized losses on a system basis were \$1,484,254 as of December 31, 1996. The Company also reacquired debt with a 7 7/8% rate due September 1, 2016; unamortized losses associated with this reacquisition were \$783,357 as of December 31, 1996.<sup>49</sup> Since the Commission has used the bottom of the range to determine whether a regulatory asset should be created in the first instance, these losses on reacquired debt can be readily addressed. The Staff’s earnings test shows test period earnings were above the Company’s authorized range, therefore the unamortized losses for the debt issues reacquired in 1996 should not be deferred and no new regulatory assets should be created for those costs incurred during the test period. The Company should expense those costs in their entirety during the test period. Appendix B hereto reflects that treatment.

The remainder of the losses on reacquired debt, however, was deferred from prior periods. In the recent rate case of *Roanoke Gas Company*, Case Nos. PUE960304 and PUE960102, I concluded that previously approved regulatory assets should only be considered recovered earlier

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<sup>45</sup>Id.

<sup>46</sup>Id. at 315.

<sup>47</sup>*Application of Appalachian Power Company*, Case No. PUE940063, 1996 S.C.C. Ann. Rep. 255, 257 (“APCO case”).

<sup>48</sup>Id.

<sup>49</sup>Exh. DTP-8, Schedule 1; Appendix A.

than anticipated with earnings in excess of the return on equity range found to be reasonable. Specifically, I reasoned that:

the Commission is not asked to take the unusual step of determining whether and to what extent a regulatory asset should be created; rather, the Commission is asked to take the equally unusual step of determining whether and to what extent previously approved regulatory assets should be considered recovered earlier than anticipated. Under an earnings test, if the Company's test period earnings are found to be within the authorized range, the earnings should be considered reasonable and neither excessive nor deficient. . . Unusual actions to defer costs actually incurred, i.e., create regulatory assets, or alter previously established amortization schedules should not be undertaken as long as earnings fall within this range of reasonableness. . . [I]f a company is found to be overearning, the fair and more balanced position, in my opinion, would be to direct the Company to treat regulatory assets as already recovered only with excessive earnings or to the top of the authorized range. Hence, earnings anywhere within the range would be considered reasonable.<sup>50</sup>

I continue to believe that unless otherwise provided for at the inception of a regulatory asset, only excess earnings should be used to reflect accelerated recovery for previously approved regulatory assets. Therefore, contrary to Staff's recommendation to use the bottom of the range in all cases, accelerated recovery of previously approved regulatory assets should be measured in terms of earnings in excess of the range previously found reasonable by the Commission. An earnings test adjusted to reflect current expensing of the 1996 losses on reacquired debt yields earnings within the Company's authorized range. Specifically Appendix B reflects a rate of return on common equity of 11.89%. Hence no previously approved regulatory assets were recovered on an accelerated basis and the Company need make no further booking adjustments.

#### *Performance-Based Plan*

Finally, the Company argues that a more appropriate means of eliminating regulatory assets would be through a Performance-Based Regulatory ("PBR") plan.<sup>51</sup> A PBR plan would be an appropriate place to review regulatory assets as well as a host of other traditional regulatory issues; however, WGL has not proposed a PBR plan here, and none is pending before the Commission. The record in this case supports application of an earnings test.

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<sup>50</sup>Roanoke Report at 9.

<sup>51</sup>Exh. FMK-10, at 10-11.

## **FINDINGS AND RECOMMENDATIONS**

In conclusion, based on the evidence received in this case, and for the reasons set forth above, I find that the Company should expense its 1996 losses on reacquired debt recovered during the test period. Since that adjustment would bring the Company's earnings into its range, no previously approved regulatory assets should be booked as recovered on an accelerated basis.

I therefore **RECOMMEND** that the Commission enter an order that:

1. **ADOPTS** the findings in this Report;
2. **DIRECTS** the Company to write off losses on reacquired debt incurred in the test period;  
and
3. **DISMISSES** this case from the docket of active proceedings.

## **COMMENTS**

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and Commission Rule 5:16(e)) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within fifteen (15) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P. O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all other counsel of record and to any party not represented by counsel.

Respectfully submitted,

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Deborah V. Ellenberg  
Chief Hearing Examiner